No. 85-1080

Supreme Court, U.S.
FILED
DEC 23 1985
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

October Term, 1985

SAN DIEGO GAS & ELECTRIC COMPANY,

Appellant,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

JURISDICTIONAL STATEMENT OF APPELLANT SAN DIEGO GAS & ELECTRIC COMPANY

Stephen L. Baum
Jeffrey L. Guttero
*Barton M. Myerson
William L. Reed

*Counsel of Record for Appellant
San Diego Gas & Electric Company
101 Ash Street
San Diego, California 92101
(619) 235-7818

INTERIM PRINTING & MAILING COMPANY
1105 WEST MORENA BOULEVARD, SAN DIEGO, CALIFORNIA 92110 — 275-3050

QUESTIONS PRESENTED

Has a utility been denied due process when a public utilities commission has determined that a past utility action was imprudent and ordered the utility to refund $45 million to its ratepayers which the utility expended pursuant to that action—

1. Where the commission judged the action from hindsight instead of from the perspective of circumstances existing when the action was taken?

2. Where the imprudence finding and refund order are not supported by any evidence and are contrary to undisputed evidence?

3. Where there was no evidence or finding that prudent management would have avoided any of the utility's disallowed expenses, and the commission excluded the utility's evidence which went to that issue?

4. Where the commission had twice previously approved the utility's recovery of expenditures for this action, and denied the utility any opportunity to mitigate its costs therefor?

THE PARTIES TO THIS PROCEEDING

The parties to this proceeding are: (1) San Diego Gas & Electric Company (SDG&E), Appellant; (2) the Public Utilities Commission of the State of California (Commission), Appellee; and the City of San Diego (City), Intervenor.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
THE PARTIES TO THIS PROCEEDING	i
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
JURISDICTION	1
CONSTITUTIONAL AND STATUTORY PROVISIONS	1
STATEMENT OF THE CASE	3
THE QUESTIONS ARE SUBSTANTIAL	9
I. THE DECISIONS BELOW RAISE RECURRING CONSTITUTIONAL ISSUES CONCERNING INCREASINGLY IMPORTANT REGULATORY REVIEWS OF MULTI-MILLION AND BILLION DOLLAR UTILITY ACTIONS	9
II. IT IS CONSTITUTIONALLY IMPERMISSIBLE TO JUDGE THE PRUDENCE OF A UTILITY'S ACTION FROM THE PERSPECTIVE OF HINDSIGHT	12
III. THERE IS NO SUBSTANTIAL EVIDENCE SUPPORTING THE COMMISSION'S FINDING OF IMPRUDENCE	16

TABLE OF CONTENTS (Continued)

		Page
	A. The Evidence Does Not Support The Finding Of Flexibility In The HIRI Contract	17
	B. The Commission's Finding That SDG&E's Own Analysis Showed The Benefits Did Not Outweigh The Risks Of The Restated Agreement Is Contrary To Undisputed Evidence	20
IV.	SDG&E WAS DENIED DUE PROCESS WHEN THE COMMISSION FAILED TO FIND THAT ANY ALTERNATIVE ACTION TO THE RESTATED AGREEMENT WOULD HAVE AVOIDED THE DISALLOWED EXPENSES, AND THE COMMISSION REJECTED SDG&E'S EVIDENCE ON THIS ISSUE	21
V.	THE COMMISSION'S $45 MILLION DISALLOWANCE IS FUNDAMENTALLY UNFAIR IN LIGHT OF ITS PRIOR APPROVAL OF THE RESTATED AGREEMENT AND ITS FAILURE TO PROVIDE SDG&E ANY OPPORTUNITY TO MITIGATE ITS COSTS THEREUNDER	24
CONCLUSION		28

TABLE OF AUTHORITIES

Page

UNITED STATES SUPREME COURT CASES

Albermarle Paper Co. v. Moody, 422 U.S. 405 (1975) 22

Atchison, Topeka & Santa Fe Railway Co. v. Public Utilities Commission of California, 346 U.S. 346 (1953) 1

Bell v. Burson, 402 U.S. 535 (1971) 22

Burlington Truck Lines, Inc. v. United States, 371 U.S. 156 (1962) 16,17

Consolidated Edison Co. v. National Labor Relations Board, 305 U.S. 197 (1938) 16

Dickerson v. Colgrove, 100 U.S. (10 Otto) 578 (1879) ... 26

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) 9,28

Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 575 (1942) 9

Heckler v. Community Health Services of Crawford County, 467 U.S. 51 (1984) 27

Interstate Commerce Commission v. J-T Transport Co., 368 U.S. 81 (1961) 16

Live Oak Water Users' Association v. Railroad Commission of California, 269 U.S. 354 (1926) 1

TABLE OF AUTHORITIES (Continued)

Page

UNITED STATES SUPREME COURT CASES (Continued)

National Labor Relations Board v. Bell Aerospace Co., 416 U.S. 267 (1974) 28

Northern Pacific Railway Co. v. Department of Public Works, 268 U.S. 39 (1925) 16

Ohio Bell Telephone Co. v. Public Utilities Commission of Ohio, 301 U.S. 292 (1937) 19

Ohio Utilities Co. v. Public Utilities Commission of Ohio, 267 U.S. 359 (1925) 20

Phelps Dodge Corp. v. National Labor Relations Board, 313 U.S. 177 (1941) 16

Securities & Exchange Commission v. Chenery Corp., 318 U.S. 80 (1943) 17

Securities & Exchange Commission v. Chenery Corp., 332 U.S. 194 (1947) 22

Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, 262 U.S. 276 (1923) 21

Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555 (1931) 23

United States v. Abilene & Southern Railway Co., 265 U.S. 274 (1924) 18

West Ohio Gas Co. v. Public Utilities Commission of Ohio (No. 1), 294 U.S. 63 (1935) 21,23

TABLE OF AUTHORITIES (Continued)

Page

UNITED STATES SUPREME COURT CASES (Continued)

Wicker v. Hoppock, 73 U.S. (6 Wall) 94 (1867) 22

CALIFORNIA SUPREME COURT CASES

Carpy v. Dowdell, 115 Cal. 667 (1897) 26

City of Long Beach v. Mansell, 3 Cal.3d 462, 476 P.2d 423, 91 Cal.Rptr. 23 (1970) 26

Gagne v. Bertran, 43 Cal.2d 481, 275 P.2d 15 (1954) ... 23

Graeber v. Derwin, 43 Cal. 495 (1872) 23

Nelson v. Black, 43 Cal.2d 612, 275 P.2d 473 (1954) 23

Seymour v. Oelrichs, 156 Cal. 782, 106 P. 88 (1909) 26

CALIFORNIA PUBLIC UTILITIES COMMISSION DECISIONS

Decision No. 85-04-111, San Diego Gas & Electric Co., (4/17/85) 1,8

Decision No. 84-12-026, San Diego Gas & Electric Co., (12/5/84) ..... passim

Decision No. 84-02-005, San Diego Gas & Electric Co., (2/1/84) ..... passim

Decision No. 82-12-056, San Diego Gas & Electric Co., 10 Cal. P.U.C. 2d 351 (12/13/82) 14

TABLE OF AUTHORITIES (Continued)

Page

CALIFORNIA PUBLIC UTILITIES COMMISSION DECISIONS (Continued)

Decision No. 82-12-054,
Southern California Gas Co., et al., 10 Cal. P.U.C. 2d 82 (12/8/82) 21

Decision No. 82-08-018,
San Diego Gas & Electric Co., 9 Cal. P.U.C. 2d 551 (8/4/82) 13

Decision No. 82-04-115,
San Diego Gas & Electric Co., 9 Cal. P.U.C. 2d 1 (4/28/82) 7,13,25

Decision No. 92304,
Pacific Gas and Electric Co., 4 Cal. P.U.C. 2d 386 (10/8/80) 13

Decision No. 90404,
San Diego Gas & Electric Co., 1 Cal. P.U.C. 2d 596 (6/5/79) 13,15,16

Decision No. 89710,
Southern California Gas Co.,
84 Cal. P.U.C. 657 (12/12/78) 14

Decision No. 89177,
In re Western LNG Terminal Associates,
84 Cal. P.U.C. 181 (7/31/78) 14

Decision No. 88835,
In re Natural Gas Supply Adjustment Mechanism,
84 Cal. P.U.C. 5 (5/16/78) 14

TABLE OF AUTHORITIES (Continued)

Page

CONSTITUTIONS

United States Constitution
Amendment V 1,7,8
Amendment XIV, Section 1 2,7,8

California Constitution
Article XII, Section 2 2
Article XII, Section 6 2

STATUTES

28 U.S.C. § 1257(2) (1977) 1

California Public Utilities Code
Section 451 (West 1975) 2
Section 701 (West 1975) 2
Section 728 (West 1975) 2
Section 1756 (West 1975) 9
Section 1757 (West 1975) 9
Section 1759 (West 1975) 9
Section 1760 (West 1975) 9

MISCELLANEOUS

Black's Law Dictionary 634 (4th ed. 1957) 27

The Prudent Investment Test In The 1980s, NRRI
(April, 1985) 11

Webster's New Collegiate Dictionary 929 (1977 ed.) 12

OPINIONS BELOW

SDG&E appeals from the final judgment of the California Supreme Court denying a Writ of Review of two decisions of the California Public Utilities Commission. The state Supreme Court's denial of the Writ of Review, which appears at page A-74 in the Appendix hereto, is not reported. The opinions of the Commission presented for review are *Application of SDG&E*, Decision No. 84-02-005, slip op. (Cal. P.U.C., Feb. 2, 1984), and *Application of SDG&E*, Decision No. 84-12-026, slip op. (Cal. P.U.C., Dec. 5, 1984), as modified by *Application of SDG&E*, Decision No. 85-04-111, slip op. (Cal. P.U.C., Apr. 17, 1985), and are printed in the Appendix hereto, pages A-1 through A-73.

JURISDICTION

The judgment of the California Supreme Court denying appellant's Writ of Review was entered on September 24, 1985. A Notice of Appeal to this Court was duly filed in the Supreme Court of California on December 2, 1985 (Appendix, p. A-75). The jurisdiction of this Court is invoked under Title 28 United States Code, Section 1257(2). For the purposes of appeal under this statute, an order of the Commission is deemed equivalent to an act of the legislature. *Atchison, Topeka & Santa Fe Railway Co. v. Public Utilities Commission of California*, 346 U.S. 346, 348-349 (1953); *Live Oak Water Users' Association v. Railroad Commission of California*, 269 U.S. 354, 356 (1926).

This appeal is being docketed in this Court within 90 days from the denial of the Writ of Review below.

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Fifth Amendment: "No person shall . . . be deprived of life, liberty, or property, without due process of law. . . ."

United States Constitution, Fourteenth Amendment, Section 1: ". . . No State shall . . . deprive any person of life, liberty, or property, without due process of law. . . ."

California Constitution, Article XII, Section 2: "Subject to statute and due process, the commission may establish its own procedures. Any commissioner as designated by the commission may hold a hearing or investigation or issue an order subject to commission approval."

California Constitution, Article XII, Section 6: "The commission may fix rates, establish rules, examine records, issue subpoenas, administer oaths, take testimony, punish for contempt, and prescribe a uniform system of accounts for all public utilities subject to its jurisdiction."

California Public Utilities Code, Section 451: "All charges demanded or received by any public utility . . . for . . . any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such . . . service is unlawful."

California Public Utilities Code, Section 701: "The commission may supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction."

California Public Utilities Code, Section 728: "Whenever the commission, after a hearing, finds that the rates . . . observed, charged, or collected by any public utility for or in connection with any service . . . are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential, the commission shall determine and fix, by order, the just, reasonable, or sufficient rates . . . to be thereafter observed and in force. . . ."

STATEMENT OF THE CASE

San Diego Gas & Electric Company (SDG&E) is a combined gas and electric utility serving approximately 875,000 electric and 560,000 gas customers in the southwestern corner of the United States. At the end of 1978, SDG&E met most of its electric load through gas- and oil-fired on-system generation, and spent approximately 50 percent of its revenue dollar on gas and oil fuels for its powerplants. At that time, SDG&E purchased almost all of its oil under two long-term contracts: One with Hawaiian Independent Refinery, Inc. (HIRI); and the other with Tesoro Alaska Petroleum Company (Tesoro).

In 1978 and 1979, SDG&E negotiated a modification to its existing low sulfur fuel oil (LSFO) supply contract with Tesoro by executing the "Restated Agreement." At that time, there was an unanticipated gas supply, below the cost of LSFO, for powerplant use. The utility industry expected this supply to be short-lived. The Restated Agreement reduced SDG&E's obligation to purchase oil in 1979, 1980, and the first half of 1981, to enable SDG&E to take advantage of this excess gas supply. At the same time, the Restated Agreement extended the Tesoro contract by 30 months beyond its scheduled June 30, 1981 expiration to provide for reliable oil supplies in 1982 and 1983 when it appeared powerplant gas would be altogether unavailable. Tesoro seemed a more reliable source for this oil in 1979 than HIRI: Tesoro utilized secure domestic crude supplies and sold LSFO to SDG&E more cheaply than HIRI, whose foreign crude supplies had recently been disrupted and who was consequently forced to reduce its deliveries to SDG&E. Following SDG&E's making of the Restated Agreement, the Commission reviewed SDG&E's expenses and operations in 1980, 1981 and the first half of 1982 under the Restated Agreement and found them prudent, subject only to minor adjustments not pertinent here.

Contrary to all predictions, however, including the Commission's own predictions, natural gas as an electric utility boiler fuel

continued to be available in 1981 and 1982, leaving SDG&E with more contract oil than it could economically burn. At the Commission's prodding, SDG&E in 1982 negotiated a suspension of the 1979 Restated Agreement (the "Suspension Agreement") in return for consideration, commonly referred to as underlift payments, totalling $45 million.

SDG&E recovers its fuel costs and related expenses under a procedure called ECAC (for Energy Cost Adjustment Clause). This is California's version of the "fuel cost adjustment proceeding" under which most utilities have recovered these costs since the early to mid 1970's, when the price and availability of fossil fuels became so volatile. The ECAC procedure involves, in part, a review of the prudence of the utility's prior year's expenses. To the extent that the Commission determines that any of the prior year's expenses were imprudently incurred, the Commission disallows those expenses and deducts them from the utility's otherwise authorized forecast energy expenses.[1]

Procedurally, this case arose out of the Commission's 1983 ECAC review of the prudence of the 1982 Tesoro Suspension Agreement. In the midst of that proceeding, intervenor City of San Diego (City) for the first time moved that the Commission review the prudence of the underlying Restated Agreement, arguing the Commission had specifically deferred a review of SDG&E's 1979 fuel costs, which would have included a review of the Restated Agreement, and had never subsequently undertaken that review. SDG&E objected that the Commission had already

---

[1] In ECAC proceedings, the Commission staff or an intervenor will typically challenge the prudence of particular expenses, and the majority of hearing time will be devoted to an examination of these issues in an adversarial atmosphere. These reviews take place in a trial-like setting, differing from trials only in the presentation of direct testimony in written form in advance of hearings, and in a somewhat relaxed application of the rules of evidence. An Administrative Law Judge presides over hearings recorded by shorthand reporters where witnesses are sworn, the scope of allowed cross-examination is broad, and contested issues are subsequently fully briefed. The Judge then prepares a draft decision which the Commission may adopt or alter.

reviewed and approved the expenses the Company had incurred from January 1980 through June 1982 under the Restated Agreement in two prior ECAC proceedings, thereby approving the contract. The Administrative Law Judge (Judge), in consultation with the assigned Commissioner, nevertheless granted the City's motion.

The Commission's subsequent review of the Restated Agreement occurred in two phases, each resulting in a separate Commission decision. The first decision was the Interim Opinion (Decision 84-02-005, issued February 1, 1984), which made certain findings of imprudence with regard to SDG&E's entering the Restated Agreement. The second decision was the Final Opinion (Decision 84-12-026, issued December 5, 1984), which imposed a $45 million disallowance on SDG&E for the imprudence found in the Interim Opinion.

The Interim Opinion concluded that SDG&E's management had been imprudent in entering the Restated Agreement, and adopted verbatim the Judge's draft. The Commission determined as Conclusions of Law:

(1) ". . . the perceived benefits [of the Restated Agreement] did not outweigh the risks shown in [SDG&E's] own economic analysis;"

(2) "SDG&E . . . failed to conduct adequate studies before entering into the 1979 Restated Agreement;"

(3) SDG&E had "attempted to shield the shareholders from Commission penalties and the short-term carrying costs of excess LSFO inventory at the long-term expense of the ratepayers;" and

(4) SDG&E had "failed to adequately consider the possibility that greater quantities of natural gas than were forecast would become available despite

> its past experience in understating gas availability."

(Appendix, p. A-25.)

Another basis for the Commission's conclusion revealed in the Findings of Fact of the Interim Opinion was—

> (5) "The 1979 Restated Agreement eliminated the flexibility in contract volumes SDG&E had in the HIRI contract and substituted an inflexible take-or-pay obligation to Tesoro."

(Appendix, p. A-23 — A-24, Finding 14.)

As a consequence of the foregoing, the Commission determined that the issue of the reasonableness of SDG&E's payment of $45 million under the subsequent Suspension Agreement was "moot." Still, the Commission was unsure what amount to disallow from SDG&E's rates for SDG&E's imprudence, and in a section of its decision entitled "*Measure of Damages*", ordered a second phase of hearings for the purpose of receiving SDG&E's and staff's—

> . . . calculation of the actual consequences of the 1979 Restated Agreement. . . . From this calculation, we will determine an appropriate disallowance. In making the ratepayer whole for the consequences of SDG&E's decision to enter into the 1979 Restated Agreement, we will consider the financial impact of a disallowance on SDG&E since the ratepayer ultimately may bear some of that impact." (Appendix, p. A-22.)

In SDG&E's view, however, all that the Interim Opinion found consisted of procedural and motivational wrongdoing which said nothing objectively good or bad about the Restated Agreement. In other words, the Commission made no finding or conclusion, given the facts and circumstances known to anyone in 1978 and

1979, that some other course of action available to SDG&E, including maintenance of the status quo, would likely have led to lower costs or otherwise have been superior to SDG&E's entering the Restated Agreement.[2] Other than SDG&E's own evidence in support of its Restated Agreement, no evidence was offered on this critical issue.

Claiming a denial of due process under the California Constitution, and under the Fifth and Fourteenth Amendments of the United States Constitution, SDG&E applied for rehearing of the Interim Opinion. It based this claim on the Commission's failure to identify a superior alternative as mentioned above, and on the additional grounds of a lack of evidentiary support for the Commission's findings, which were in fact contrary to undisputed evidence; the inconsistency and contradictions of the findings and conclusions with previous Commission decisions approving the Restated Agreement; and the Commission's failure to judge the prudence of the Restated Agreement from the perspective of facts and circumstances known at the time the contract was entered. Before the Commission ruled on SDG&E's application for rehearing, the Commission held hearings on the second (or penalty) phase of its prudence inquiry.

In the second phase of hearings, SDG&E attempted to identify the conduct against which the Restated Agreement should be compared to calculate a disallowance, which the Interim Opinion failed to do. It offered the testimony of three nationally recognized energy economists, John O'Leary, William R. Hughes and Arlon R. Tussing. Each independently concluded that, even accepting the Interim Opinion's criticisms of inadequate procedures and improper motivations, each would have recommended in 1979 that SDG&E pursue a fuel strategy roughly comparable to that adopted

---

[2] The pre-existing status quo cannot automatically be accepted as the natural alternative to any action being reviewed because the Commission does not presume the status quo is reasonable. It made that clear in Decision 82-04-115 when it told SDG&E it faced possible future disallowances if it did not alter the status quo of its fuel supply.

in the Restated Agreement. None of them believed that maintenance of the status quo would have been reasonable. They thus concluded there were virtually no negative "consequences" of the 1979 Restated Agreement. But because the Commission concluded that proffered testimony only attempted to "reargue" the reasonableness of the Restated Agreement, the Commission struck all of it.

The Final Opinion, issued after the second phase of hearings, reviewed several damage calculations presented by the parties. The details of these calculations are not relevant here, because the Commission declined to base its disallowance on any of them. The totality of the Commission's analysis of the "actual consequences" of the Restated Agreement and adoption of a disallowance is given at p. 31 of the Final Opinion (Appendix, p. A-57), where the Commission states:

> In reviewing the full range of figures developed in this record, we conclude that the only solid figure is the underlift penalty associated with the Suspension Agreement[3]. . . . [W]e know that from October 1, 1982 to December 31, 1983, SDG&E did not receive any LSFO from Tesoro and instead paid a $6.55/bbl underlift penalty, or a total of $45,060,000 in underlift penalties. This is the amount we will disallow.

SDG&E duly filed its Application for Rehearing of the Final Opinion on January 4, 1985, again arguing that it had been denied due process of law under the California Constitution and the Fifth and Fourteenth Amendments of the United States Constitution. In so doing, SDG&E argued the Final Opinion was subject to all the same federal constitutional infirmities as the Interim Opinion. On April 17, 1985, in Decision 85-04-111, the Commission

---

[3] It was the reasonableness of this agreement which the Commission declared "moot" in its Interim Opinion. The Commission made no findings or conclusions respecting the prudence of this contract. (Appendix, p. A-21.)

modified the Final Opinion in several insubstantial respects and denied rehearing of it and the Interim Opinion. (Appendix, pp. A-67 — A-73.)

On May 21, 1985, SDG&E timely filed its Petition for Writ of Review of the three Commission decisions with the California Supreme Court, pursuant to Public Utilities Code Sections 1756, 1757, 1759 and 1760. SDG&E again claimed a denial, *inter alia*, of its federal constitutionally guaranteed right to due process of law by virtue of the Commission's decisions on all of the grounds SDG&E had previously asserted in its applications for rehearing of those decisions. On September 24, 1985, the California Supreme Court denied SDG&E's petition in a one line order (Appendix, p. A-74). SDG&E did not seek rehearing of that denial. On December 2, 1985, SDG&E filed its Notice of Appeal of that denial with that Court (Appendix, p. A-75).

THE QUESTIONS ARE SUBSTANTIAL

I.

THE DECISIONS BELOW RAISE RECURRING CONSTITUTIONAL ISSUES CONCERNING INCREASINGLY IMPORTANT REGULATORY REVIEWS OF MULTI-MILLION AND BILLION DOLLAR UTILITY ACTIONS.

This Court's attention to the due process issues in utility rate proceedings raised by this case is particularly important at this time, and these issues are ripe for review. This Court has not dealt with such issues for over 40 years, since *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942); and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). Despite several opportunities, the California Supreme Court has declined to deal with these issues in the context of utility prudence reviews. The sole means California provides for review of Public Utilities Commission decisions is a discretionary petition for

Writ of Review to the California Supreme Court. That discretion has rarely been exercised, however, and the due process limitations on the Commission's exercise of its authority in the area of prudence reviews is accordingly not well defined. Given the nearly $12 billion currently subject to such review by the California Commission (Appendix, p. 78), the issues appellant presents here are especially ripe for this Court's consideration.

This appeal presents the Court with an opportunity to reaffirm the importance of due process requirements in a type of utility rate proceeding which is now surpassing, both in frequency and in dollar magnitude, the importance of general rate proceedings. These are the prudence reviews that occur in fuel cost adjustment proceedings like ECAC and in major plant addition applications. In the first type of case, utilities are essentially guaranteed dollar-for-dollar recovery of their fuel costs, *if they are found prudent*. In the late 1970s and early 1980s, SDG&E recovered over half its total revenues in such proceedings. For the second category of cases, utilities are allowed to add their investment in new plant to rate base, again, *if the investments are found prudent*. Today, these investments often consist of multi-billion dollar nuclear facilities.

Although the rate impact of these proceedings can often equal or exceed that of general rate cases, they are different from general rate proceedings and are quasi-judicial instead of quasi-legislative in nature. A commission reviews expenditures the utility has already made, and in the case of fuel offset cases, has sometimes already recovered in its rates. Rate of return is not at issue, nor the reasonably expected level of the utility's future expenses, to which level it will be held. In these cases, the utility is nearly always entitled to either total recovery of its actual expenses or total inclusion in rate base of its plant investment *if the expenditures are found to have been prudent*.

A recent survey shows that utility prudence reviews are increasingly common occurrences. Of state electric and gas utility cases reported in the Public Utility Reports Digest making significant

use of the "prudent investment test"[4], five such cases were found from 1944-1953, one from 1954-1963, three from 1964-1973, and *42* from 1974-1983. And as mentioned above, the California Commission alone is reviewing or is about to review nearly $12 billion in energy and new plant expenditures. (See Appendix, p. A-78 for an itemization.) On a national level, the amount under scrutiny is many times greater.

Due process in the conduct of these reviews is especially important today. The cost of all energy has increased enormously over the last decade. Not only have the costs of fossil fuels risen dramatically, but the capital costs of nuclear plants that were thought to offer lower cost alternatives to fossil fuels have also risen dramatically. Nuclear plants that were expected to cost $400 to $500 million have actually cost eight to ten times that amount. Neither consumers nor regulatory commissions have accepted these shocks to their expectations with equanimity. The pressure on commissions is great to ferret out all conceivable excesses in these purchases and investments in order to lower utilities' rate base and provide some respite to ratepayers who can find little relief in the reality of today's energy costs.

But the costs of any commission's failure to exercise its regulatory authority in a constitutionally scrupulous manner is great to all of society. Monday morning quarter-backing of a utility's fuel costs and investments by a commission is most likely to occur with long-term decisions where the probability is the greatest that events will turn out differently than expected. If utilities are usually penalized when their predictions turn out to be wrong though, management will cut its risks by only making shorter term "safe" decisions, even when circumstances at the time indicate a longer term decision is more likely to benefit ratepayers. And utilities who are denied the opportunity to earn a fair return on their new

---

[4] This survey was prepared by the National Regulatory Research Institute (NRRI) with funding provided by participating member commissions of the National Association of Regulatory Utility Commissioners (NARUC). *The Prudent Investment Test In The 1980s*, NRRI (April, 1985).

plant additions, because they are only allowed to earn on less than their full investment, will be considered riskier investments for stock and bondholders, who will demand a greater return. In each instance, rates can increase for millions of users.

Disallowances for imprudence, when made, must be accepted by utilities and their equity holders, as well as their ratepayers, as *fair* regulatory assessments, not arbitrary action. Otherwise, utilities will actually be driven away from prudent decision-making toward mere risk reduction. The Supreme Court should reaffirm the requirements for due process in state utility prudence reviews.

II.

IT IS CONSTITUTIONALLY IMPERMISSIBLE TO JUDGE THE PRUDENCE OF A UTILITY'S ACTION FROM THE PERSPECTIVE OF HINDSIGHT.

A constitutional failing of the decisions below is that, both in particular findings and overall, they judge the prudence of SDG&E's Restated Agreement from the perspective of 20-20 hindsight, and not from the perspective of facts and circumstances known in 1978-1979. A hindsight-based reasonableness review denies a fundamentally fair hearing required by the due process clause, because it judges only a utility's fortune-telling ability, and not its "ability to govern and discipline [it]self by the use of reason," involving its "skill and good judgment in the use of resources." (*Prudence*, as defined by *Webster's New Collegiate Dictionary*.) In other words, a prudence review based on hindsight cannot constitute a prudence review at all and would constitute arbitrary state action.

Appellant has discovered no regulatory commission that has considered this issue which has concluded prudence can be determined other than by the commission's putting itself in the shoes the utility was wearing *at the time* it considered and undertook the action being scrutinized. Among the commissions adopting a

forward-looking, and rejecting a hindsight, prudence analysis are Maine, Michigan, Missouri, Montana, New Jersey, New York, Pennsylvania, Texas and the Federal Energy Regulatory Commission (FERC). The California Public Utilities Commission has itself recognized the essential soundness of this proposition in a number of its own decisions, stating that the reasonableness of management's actions must be determined in the context of the information and circumstances which existed at the time the decisions were made. (Decision 90404, 1 Cal. P.U.C. 2d 596, 623 (1979); Decision 92304, 4 Cal. P.U.C. 2d 386, 392 (1980); Decision 82-08-018, 9 Cal. P.U.C. 2d 551, 572 (1982).) The problem here, then, is not with the applicable standard, but with its implementation.

The hindsight basis of the Commission's imprudence finding is revealed by reference to two earlier Commission ECAC proceedings which reviewed the reasonableness of the Restated Agreement closer in time to the execution of that contract, and for periods when the contract was generating more benefits than costs. In late 1981, the Commission reviewed the reasonableness of SDG&E's fuel and related expenses, including those incurred under the Restated Agreement, for the period January 1980 through June 1981. The Commission staff prepared a written report analyzing the Restated Agreement and concluded it was "*very favorable* to both the utility and the ratepayers for a number of reasons." (Emphasis added.) Moreover, there was *no* evidence to the contrary. The Commission's decision in that case (Decision 82-04-115) made a Finding of Fact that:

> 12. SDG&E's operations and expenses for the period January 1980 through June 30, 1981 were reasonable. (9 Cal. P.U.C. 2d 1, 24.)

In late 1982 the Commission reviewed the prudence of SDG&E's fuel and related expenses, including expenses incurred under the Restated Agreement, for July 1981 through June 1982. This review was conducted at a time by which both the company and

the Commission knew the continuing availability of natural gas meant SDG&E had more oil under contract than was desirable. Nevertheless, the Commission decided in its Findings of Fact in Decision 82-12-056 that:

> 12. . . . SDG&E's operations and expenses for the period July 1, 1981 through June 30, 1982 were generally reasonable. . . . (10 Cal. P.U.C. 2d 351, 376)

The Commission never explains in its Interim Opinion, however, what happened *after* June 1982 to make the Restated Agreement unreasonable *from its inception*. Only hindsight can be used to answer that question.

Another clear example of the hindsight nature of the Commission's imprudence determination concerns its findings in the Interim Opinion that SDG&E had placed too great a reliance on its gas forecasts of 1978, which had shown that the availability of powerplant gas past 1981 was very questionable. These forecasts had led SDG&E to contract in the Restated Agreement for a relatively reliable future oil supply. The Commission concluded that SDG&E should have considered the "possibility" that more gas than forecast would actually have become available because--and for this reason alone--SDG&E had under-forecast gas availability over the previous several years.

There was little question in 1978 and 1979 as to the certainty of future gas supplies: it was highly questionable, especially for low priority users such as powerplants. This was clearer to no one than the Commission itself. In three decisions[5] the Commission rendered in 1978 alone, the Commission found that gas supplies in general, and powerplant supplies in particular, could be in short supply by as early as 1981, and almost certainly by 1982 and 1983.

---

[5] *In re Natural Gas Supply Adjustment Mechanism*, 84 Cal. P.U.C. 5, 8, 14; *In re Western LNG Terminal Associates*, 84 Cal. P.U.C. 181, mimeo, p. A-310; *Southern California Gas Company*, 84 Cal. P.U.C. 657, 689.

Even in 1980, after SDG&E signed the Restated Agreement, a Commission staff forecast for California's gas distribution utilities predicted an average-year powerplant gas level of only 4 percent for 1982 and 0 percent for 1983.[6]

In fact, in a decision the Commission rendered only days after SDG&E signed the Restated Agreement, the Commission specifically rejected the very criticism it leveled at SDG&E in the Interim Opinion! In the proceeding leading to Decision 90404, issued June 6, 1979, the Commission staff had argued SDG&E was imprudent to continue to place virtually full reliance on the powerplant gas forecasts of its supplier when those forecasts regularly underestimated gas availability. Answering this criticism in Decision 90404, the Commission noted the conclusion of consultants, whom the Commission had ordered SDG&E to retain to evaluate its fuel planning and purchasing practices, and who said:

> . . . "[i]t was not possible to foresee or plan for the large quantities of interruptible P-5 gas becoming available that forced oil sales. . . ." (1 Cal. P.U.C. 2d 596, 625.)

In light of Southern California Edison's and Pacific Gas and Electric Company's also having overestimated their fuel oil requirements (by underestimating their gas supplies), the Commission then concluded:

> . . . it is unlikely that an effort more independent of SoCal (SDG&E's gas supplier) by SDG&E would have yielded a much different result. Moreover, if it did, SDG&E would have had to accept not only exposure to the risks and criticism of second guessing its supplier but to departing from "available information and historic state and nationwide

---

[6] Report No. 2, "Report of Forecast of Natural Gas Supply, Requirements and Costs 1980 - 1989 for California Distribution Utilities, published by CPUC Staff.

> trends." (Decision 90404, 1 Cal. P.U.C. 2d 596 at p. 625.)

What could have caused the Commission to so change its view from 1978-1980 to 1984? Only its then-perfect knowledge that the forecasts of that time, including its own, were wrong.

III.

THERE IS NO SUBSTANTIAL EVIDENCE SUPPORTING THE COMMISSION'S FINDING OF IMPRUDENCE.

This Court has held in various administrative circumstances that to meet the requirements of due process, an agency must make findings that support its decision, and those findings must be supported by substantial evidence. *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962); *Interstate Commerce Commission v. J-T Transport Co.*, 368 U.S. 81, 93 (1961). For courts to be able to determine whether an agency has exercised its authority within legal bounds, the agency must "disclose the basis of its order." *Phelps Dodge Corp. v. National Labor Relations Board*, 313 U.S. 177, 197 (1941). The Court has interpreted "substantial evidence" to consist of—

> [M]ore than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. (*Consolidated Edison Co. v. National Labor Relations Board*, 305 U.S. 197, 229 (1938).)

An order which is based on a finding without evidence, or on evidence which clearly does not support it, is an arbitrary act and a denial of due process. *Northern Pacific Railway Co. v. Department of Public Works*, 268 U.S. 39 (1925).

While the Commission criticized SDG&E on five or six specific grounds in the Interim Opinion, its conclusion that the Restated

Agreement was unreasonable is based on only three: 1) giving up HIRI contract "flexibility" for the inflexible Restated Agreement, 2) SDG&E's own analysis purportedly showing the risks of the Restated Agreement were not outweighed by its benefits, and 3) SDG&E's attempt to shield its shareholders from Commission penalties.[7] Since these are the Commission's stated grounds, its imprudence finding must be judged solely by their adequacy and propriety. *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168-169 (1962); *Securities & Exchange Commission v. Chenery Corp.*, 318 U.S. 80 (1943). For an agency's order must be upheld, if at all, on the same basis articulated by the agency itself. A court will not attempt to sustain an agency's order by substituting what it considers to be an adequate basis for the ruling.

Accordingly, appellant restricts its discussion of evidentiary shortcomings to these grounds, and deals with the first two grounds in more detail below. The third ground, however, even if supported by evidence, is irrelevant to an imprudence finding and appellant does not separately discuss it; an attempt by SDG&E to shield its shareholders from Commission penalties says even less than the other two grounds about whether the Restated Agreement was unfavorable to ratepayers.

A. The Evidence Does Not Support The Finding Of Flexibility In The HIRI Contract.

At the time SDG&E negotiated and executed the Restated Agreement with Tesoro, it was purchasing LSFO from HIRI

---

[7] The Final Opinion (Appendix, p. A-60) states that the "primary finding" of the Interim Opinion that the Restated Agreement was unreasonable was "not dependent on the latter discussion [in the Interim Opinion] which identifies additional conduct by SDG&E that was unreasonable." A review of the Interim Opinion shows the Commission concluded by the middle of p. 18 (Appendix, p. A-18) that SDG&E had been "unreasonable in signing the agreement based upon the information available to SDG&E at the time it entered into the Agreement." The Commission's conclusion, then, must be based on the criticisms of SDG&E it discusses *before* reaching that conclusion. Those are the three findings listed above.

pursuant to Amendment No. 7 of their original agreement. This amendment provided that SDG&E would purchase from HIRI from 1981 through the termination of the contract in 1984 the volume of 14,000 barrels per day (14 MBD), unless SDG&E opted to purchase the higher volume of 28.8 MBD. SDG&E was obligated to notify HIRI two years in advance if it wished to receive the higher volume. No provision was made for SDG&E's purchase of any other volumes in those years.

The Commission found in its Interim Opinion that SDG&E's substitution of the inflexible Restated Agreement for the "flexible" HIRI option to vary volumes "reflects extremely poor management judgment." (Appendix, p. A-16.) This conclusion was drawn solely from the Commission's interpretation of Amendment No. 7 to the HIRI agreement, which was never even discussed on the record, let alone introduced into evidence at the hearings. To this day, SDG&E does not know the source of the Commission's information about this document. Nevertheless, the Commission apparently read Amendment No. 7 or learned of its purported content outside of the hearings and briefs before it, found that it contained "flexibility" contrary to its plain and true meaning, and drew its conclusion critical of the Restated Agreement, all revealed for the first time in its Interim Opinion.

This Court stated long ago that "[n]othing can be treated as evidence which is not introduced as such." *United States v. Abilene & Southern Railway Co.*, 265 U.S. 274, 288 (1924). The commission there took judicial notice of information from annual reports filed by law with the commission, and used information from them as evidence of facts which it deemed necessary to prove, without notice of that intended use to parties. This Court found such use denied due process since it denied the carriers involved of notice of the evidence with which they were, in fact, confronted, as later disclosed in findings. SDG&E has as surely been denied due process here by the Commission's use of Amendment No. 7.

Further, the Commission concluded that Amendment No. 7 gave SDG&E the right to select *any* volumes from HIRI starting in 1981 between 14 MBD and 28.8 MBD, not just one or the other of those discrete volumes as is its correct meaning. The issue was never presented in the case and no evidence even remotely dealt with that amendment. The evidence supporting the Commission's finding cannot be known. This finding suffers the same due process infirmities identified by this Court in *Ohio Bell Telephone Co. v. Public Utilities Commission of Ohio*, 301 U.S. 292 (1937). There, the parties and the Court were entirely unable to determine the basis for a commission's finding of certain evidentiary facts which it withheld from the record and refused to disclose.

SDG&E argued against the Commission's interpretation in its Application for Rehearing of the Interim Opinion. The Judge then informed the Company he wished to examine an SDG&E witness on this issue in the penalty phase hearings on the Restated Agreement. From the Judge's cross-examination, the Commission altered its view of the "HIRI option" in its Final Opinion. It there concluded that HIRI contract flexibility adhered in SDG&E's supposed ability to *negotiate* volume changes to that contract, not in the contract itself (Appendix, pp. A-61 — A-62). No evidence was presented, however, that SDG&E could have negotiated the changes the Commission would have deemed an appropriate Restated Agreement substitute, nor did the Commission ever say what those revised HIRI volumes should have been.

The Commission's schizophrenic attitude toward the basis for its finding of HIRI contract "flexibility" underscores the lack of any evidence for it. In short, the Commission had no evidence from which to draw *any* conclusions about HIRI Amendment No. 7. In doing so, it has denied SDG&E due process of law under the federal Constitution.

B. The Commission's Finding That SDG&E's Own Analysis Showed The Benefits Did Not Outweigh The Risks Of The Restated Agreement Is Contrary To Undisputed Evidence.

In *Ohio Utilities Co. v. Public Utilities Commission of Ohio*, 267 U.S. 359 (1925), this Court rejected on due process grounds a commission finding of utility management imprudence that was not only without evidence, but also contrary to undisputed evidence. In the Interim Opinion, the California Commission concluded that the $500,000's worth of benefits which the company expected from Restated Agreement volume reductions in 1979 and 1980 were not equal to the risks of excess oil it created in 1981-1983, *according to SDG&E's own analysis*. This finding, too, is without supporting evidence and contrary to undisputed evidence.

This finding denies SDG&E due process. It is contrary to uncontradicted testimony that the $500,000 represented the net present value of the Restated Agreement *for its entire period* compared to what it replaced. This is apparent from a reading of the analysis in which it was contained and from the uncontradicted testimony of the witness who sponsored the analysis at hearings. No one ever argued, let alone presented evidence, that the $500,000 benefit was deemed to be restricted to the early years' effects of that contract.

Furthermore, the Commission ignores uncontradicted record evidence that the Restated Agreement gave the company the additional benefit of a reliable, domestic supply of fuel oil in years when gas was expected to be in short supply. This is opposed to the Commission's unsupported conclusion that SDG&E should have established a greater reliance on HIRI-supplied oil, which the evidence showed without contradiction was subject to interruption and more costly than Tesoro oil.

For the reasons stated above, the Commission's conclusion that the Restated Agreement was unreasonable is unsupported by any evidence and is contrary to undisputed record evidence. This

conclusion deprives SDG&E of due process of law and cannot therefore serve as a basis on which to assess any disallowance against SDG&E.

IV.

SDG&E WAS DENIED DUE PROCESS WHEN THE COMMISSION FAILED TO FIND THAT ANY ALTERNATIVE ACTION TO THE RESTATED AGREEMENT WOULD HAVE AVOIDED THE DISALLOWED EXPENSES, AND THE COMMISSION REJECTED SDG&E'S EVIDENCE ON THIS ISSUE.

A public utility is entitled to recovery of its reasonably incurred expenses. *West Ohio Gas Co. v. Public Utilities Commission of Ohio (No. 1)*, 294 U.S. 63, 72 (1935); *Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276, 289 (1922). The California Public Utilities Commission acknowledges this precept:

> Regulatory law is well-settled that the Commission may disallow for ratemaking purposes any unreasonable expense if it is supported by findings of fact and conclusions of law. *If the Commission disallowed an expense it found to be reasonable, that action would be a confiscation of stockholder property*. [Emphasis added.] (Decision 82-12-054, 10 Cal. P.U.C. 2d 82, 121-122.)

This Court has also recognized that a simple but fundamental rule of—

> . . . administrative law . . . is to the effect that a reviewing court, in dealing with a determination . . . which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the

> agency. (*Securities & Exchange Commission v. Chenery Corp.*, 332 U.S. 194, 196 (1947).)

If those grounds are inadequate, the court is powerless to affirm the administrative action by substituting what it considers to be a more adequate basis. The Commission here has stated that its basis for determination of a disallowance would be ratepayer damages measured by the "actual consequences" of the Restated Agreement. This standard is as unmistakably clear as the kind of factual analysis it requires: that "but for" the allegedly imprudent action, the expenses to be disallowed would have been avoided. *See Bell v. Burson*, 402 U.S. 535, 541 (1971).

In *Albermarle Paper Co. v. Moody*, 422 U.S. 405 (1975), at pp. 418-419, the Court repeated the means by which damages are measured for an economic injury:

> [t]he general rule is, that when a wrong has been done, and the law gives a remedy, the compensation shall be equal to the injury. The latter is the standard by which the former is to be measured. The injured party is to be placed, as near as may be, in the situation he would have occupied if the wrong had not been committed. (*Wicker v. Hoppock*, 73 U.S. (6 Wall) 94, 99 (1867).)

Obviously, if the injured party would be in the same position if the wrong *had not been* committed as if it *had*, he would *not* be entitled to compensation. This test thus precludes the Commission from disallowing expenses claimed to have been imprudently incurred unless it finds that some more prudent action would have avoided them. It is insufficient as a basis for disallowance that the Commission merely find imperfections in the process by which SDG&E incurred those costs. The prudence of the process says nothing about whether the decision it led to was favorable or unfavorable to ratepayers. Where the Commission declares, as here, that the disallowance shall be measured by ratepayer damages, its failure to identify the more prudent action, against which the challenged action must be measured, necessarily precludes any determination or

calculation of ratepayer damages. For example, even where one has been negligent but his conduct has not injured another party, no one is entitled to compensation because there is no "actual detriment" to support an award of damages. *See, e.g., Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931); *Nelson v. Black*, 43 Cal.2d 612, 613-614, 275 P.2d 473, 474 (1954); *Gagne v. Bertran*, 43 Cal.2d 481, 492, 275 P.2d 15, 22-23 (1954); *Graeber v. Derwin*, 43 Cal. 495 (1872).

The Commission has failed to establish the fact of damage here. Even if it found "imprudence," it has failed to find, and took no evidence from which it could find, that some other action on the part of SDG&E in 1978-1979, including maintenance of the *status quo* (see footnote No. 2), would have avoided the expenses under the Restated Agreement which it ordered the Company to refund to its ratepayers.

Furthermore, the Commission improperly rejected the testimony of SDG&E's highly qualified outside consultants which went to the issue of the fact and extent of damages. And while this evidence would have tended to discount the likelihood that SDG&E's action did disadvantage its ratepayers, and was probably the reason the Commission rejected it, it is the only evidence anyone offered which attempted to address the issue of what SDG&E should have done in 1979 with respect to its existing fuel supply status.[8]

This appeal has a parallel in *West Ohio Gas Co. v. Public Utilities Commission of Ohio*, 294 U.S. 63 (1935). The utility there offered uncontradicted evidence that a nine per cent system gas loss was unavoidable with the most prudent of operations. The

---

[8] Lest anyone suggest the Commission staff's phase two testimony did that, even the Commission had to acknowledge that staff's proposed disallowance did not attempt to limit itself to the allegedly deleterious effects of the Restated Agreement: "We agree that staff has calculated 'credits' and 'penalties' on LSFO quantities which exceed the volume changes negotiated in the [Restated] Agreement." Final Opinion, Appendix, p. A-51.

Ohio commission concluded, however, that more prudent management could reduce the loss to seven per cent, the amount it allowed in rates. No evidence supported the Commission's conclusion, however, and this Court held that without evidence that better utility performance would lower its costs, the utility was entitled to recovery of the full nine per cent loss.

The California Commission nevertheless denies the need for determining the appropriate alternative to SDG&E's execution of the Restated Agreement. In its Final Opinion, it said:

> SDG&E also argues that since the Interim Opinion did not describe an alternative course of action, the Commission has not yet determined that the Agreement was unreasonable, just SDG&E's procedures and motivations. There are *many* reasonable courses of action that SDG&E could have followed in 1979. The Agreement was not one of them. [Emphasis in original.] (Appendix, p. A-60.)

The statement also serves as a succinct acknowledgement that the Commission has failed to make *the* essential finding for imposing a disallowance. In nevertheless ordering the ratepayer refund, and in refusing to hear SDG&E's evidence on this essential issue, the Commission has denied SDG&E the due process of law to which it is entitled under the United States Constitution.

V.

THE COMMISSION'S $45 MILLION DISALLOWANCE IS FUNDAMENTALLY UNFAIR IN LIGHT OF ITS PRIOR APPROVAL OF THE RESTATED AGREEMENT AND ITS FAILURE TO PROVIDE SDG&E ANY OPPORTUNITY TO MITIGATE ITS COSTS THEREUNDER.

SDG&E's 1979 Restated Agreement should fairly have been reviewed by the Commission shortly after its signing. However,

the Commission had previously decided to delay its review of the reasonableness of California utilities' operations and expenses at this time because of its pending generic review of the ECAC mechanism. Although reasonableness reviews were temporarily in hiatus, the Commission specifically authorized parties to raise and develop reasonableness issues for future determination.

The Commission's final decision in its generic investigation was issued in December of 1980. It determined that the period subject to reasonableness review for SDG&E's initial application under the revised ECAC procedure was January 1980 through June 1981. The Commission further stated that the only issues prior to this period which would be subject to review were those that had been specifically identified and carried forward by prior decisions. Neither the Restated Agreement nor its associated fuel costs had been so identified.

The Commission's decision on SDG&E's first ECAC fuel cost application was not issued until April of 1982. That decision (Decision 82-04-115) found SDG&E's operations and expenses for that intitial January 1980 through June 1981 review period to be reasonable.

In spite of this finding, the Commission clearly stated in its April 1982 decision that, if SDG&E did not soon solve its then-existing fuel oil oversupply, it would consider imposing a penalty. In addition, the Commission issued an Order to Show Cause (OSC) why it should not simply order SDG&E to cease accepting oil from Tesoro. The Restated Agreement contained a *force majeure* provision which may have given the Commission the right to suspend the contract. SDG&E responded to the Commission's prodding by negotiating the Suspension Agreement with Tesoro in August of 1982, only four months after the Commission's direction to eliminate its oil oversupply in the near future.

Upon learning of the details of the Suspension Agreement, including SDG&E's obligation to pay Tesoro $45 million for

terminating the sale of all remaining Restated Agreement volumes, the Commission terminated its OSC. This action was necessary as a condition precedent to effectuation of the Suspension Agreement. The Commission simultaneously deferred the reasonableness review of the Suspension Agreement and its costs to a future proceeding. It was during this deferred review, which ultimately took place more than one year later, in late 1983, that the Commission decided that SDG&E's actions in *1979* had been imprudent.

SDG&E submits that the Commission must, for the sake of fundamental fairness, be estopped from asserting now that SDG&E's actions in 1979 were imprudent. The Commission's action is not only a reversal of its prior determinations made closer in time to the events being judged, but it also comes at a time when SDG&E, through direct compliance with Commission orders, and as a direct result of the Commission's actions, has been denied any opportunity to mitigate the damages now deemed to have occurred.

This Court said in *Dickerson v. Colgrove*, 100 U.S. (10 Otto) 578, 580 (1879):

> The vital principle is that he who by his language or conduct leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a change of position is sternly forbidden. It involves fraud and falsehood, and the law abhors both.

This principle of equitable estoppel has been favorably cited on numerous occasions by the California Supreme Court, including *Carpy v. Dowdell*, 115 Cal. 677, 687 (1897); *Seymour v. Oelrichs*, 156 Cal. 782, 795; 106 P. 88, 94 (1909); and *City of Long Beach v. Mansell*, 3 Cal.3d 462, 488; 476 P.2d 423, 442; 91 Cal.Rptr. 23, 42 (1970). Use of this principle in the *City of Long Beach* case is particularly germane here because the California Supreme Court ap-

plied the principle against the City of Long Beach and the State of California in favor of private property owners. Thus, the California Court was able to overcome the reservations expressed by this Court in *Heckler v. Community Health Services of Crawford County*, 467 U.S. 51 (1984), where the opinion indicated this Court doubted it would ever be presented with facts justifying an estoppel against the government.

SDG&E believes that equitable estoppel is based on the concepts embodied in fundamental fairness and due process. *Black's Law Dictionary* defines "equity" as denoting "the spirit and the habit of fairness, justness, and right dealing. . . ." Those characteristics are missing here.

It should be recalled that the Commission's own procedures denied SDG&E timely review of its 1979 Restated Agreement. When SDG&E's operations and expenses were thoroughly reviewed and discussed by the Commission three years after the signing of the Restated Agreement, the Commission explicitly found SDG&E's actions during the bulk of that period to be reasonable, and reserved judgment on none of SDG&E's prior actions. SDG&E was justifiably led to conclude that its actions prior to April 1982, including the signing of the Restated Agreement, were deemed reasonable, and only its subsequent activities were subject to future review.

With this understanding, SDG&E believed that the Suspension Agreement with Tesoro, negotiated in the summer of 1982, was a fair solution for its then-existing oil oversupply. The Commission's decision to terminate its pending OSC, thereby expressly making the Suspension Agreement operative, and ending any opportunity for the Commission to simply order the termination of the Restated Agreement at no cost to SDG&E, was the act which caused the incurrence of the very costs which the Commission now claims are the results of SDG&E's imprudence. Simply continuing the OSC would have forced some other resolution of the oversupply problem. Obviously, SDG&E might have

experienced very different costs if the Commission had rejected the Suspension Agreement, or had earlier stated that the Restated Agreement was unreasonable. The Commission took none of these actions but, in fact, acted contrarily.

The Supreme Court's explanation of why it would *not* estop certain NLRB action in *National Labor Relations Board v. Bell Aerospace Co.*, 416 U.S. 267 (1974), at 295, tells why it *should* estop the Commission's action here:

> Furthermore, this is not a case in which some new liability is sought to be imposed on individuals for past actions which were taken in good-faith reliance on Board pronouncements. Nor are fines or damages involved here. In any event, concern about such consequences is largely speculative. . . .

The Commission should be estopped from now assessing a disallowance against SDG&E.

CONCLUSION

The California Public Utilities Commission's decision ordering SDG&E to refund $45 million to its ratepayers is arbitrary. The California Supreme Court has exhibited no interest in reviewing this or other "prudence" cases. This Court's refusal to hear and reverse this decision will confirm the California Commission's power to capriciously disallow expenses, without constitutional constraints, which utilities are otherwise legally entitled to recover. Because appellant's case presents a representative example of how utility ratemaking has fundamentally changed since this Court ruled in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), the Court should take the opportunity appellant presents here to reaffirm the due process requirements in utility

ratemaking for not only the California Commission, but for utility commissions nationwide.

Dated: December 19, 1985

Respectfully submitted,

Barton M. Myerson
Counsel of Record for Appellant
Stephen L. Baum
Jeffrey L. Guttero
William L. Reed
SAN DIEGO GAS & ELECTRIC COMPANY